TRADE POLICY IN THE U.S.-JAPAN RELATIONSHIP: 1993 TO 2000

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National Press Club
Tokyo, Japan

July 19, 2000

Thank you very much. I am very pleased to be here in Tokyo again. We have come with a full agenda, and had a productive visit so far.

We have agreed on two items in our bilateral agenda, covering telecommunications and new measures under our Enhanced Initiative on Deregulation and Competition Policy. We are reviewing options for the launch of a new Round of negotiations at the WTO; and briefing our Japanese colleagues on our historic Bilateral Commercial Agreement with Vietnam, progress toward permanent Normal Trade Relations for China, preparation for the APEC Leaders meeting in Brunei, and other areas of mutual concern. Before I turn to these issues, however, I would like to place them in context, with some more general thoughts on the place of trade in our relationship with Japan, and the work before us as we enter the new century.

THE US-JAPAN RELATIONSHIP IN THE 1990S

My first official visit to Japan was in preparation for the G-7 meeting in Tokyo in 1993. In the years between that event and this week's G-8 meeting, we may have devoted more time and resources to the relationship with Japan than to any other. That reflects the importance and magnitude of our trade relationship; the responsibility our two countries share for world prosperity; and the complexity and difficulty of the issues we confront.

In 1993, we came to Tokyo recognizing, first of all, that this was a relationship of central importance -- for Americans, for Japanese, and for all our Pacific neighbors. The end of the Cold War had, of course, brought us into a new era. But it remained true then as now than that every challenge before us -- keeping the peace in a changing Pacific region; protecting the environment; building prosperity in our two countries and the region we share -- will be more easily met with a close and enduring alliance between the United States and Japan: the world's two greatest economies, its leading technological powers, and the largest Pacific democracies.

Second, in this new era we would build on a strong foundation. We inherited a security alliance four decades old, which was and remains the foundation of peace and security in the Pacific. Our trade negotiations would deal with one of the world's largest and deepest economic relationships: in 1993, $180 billion in two-way goods and services trade, spanning aircraft, computers, satellites, agriculture and much more. And in trade as elsewhere, negotiations between governments would be only one element in the total relationship, with its deep and complex network of business associations, personal friendships, academic and cultural links, and family ties across the Pacific.

But third, trade policy would proceed in an environment marked by deeply rooted tension and disagreement. The 1980s had witnessed a sharply escalating series of disputes. Some – beef, semiconductors, autos, supercomputers – had been addressed with greater or lesser success in specific agreements; but neither country had seemed willing to make more basic reforms to place our trade relationship on a healthier foundation. The United States had not restored fiscal discipline. Japan remained a substantially more closed and highly regulated economy, sharply limiting imports and accepting virtually no foreign direct investment. And in removing a common threat, the end of the Cold War made these frustrations a more central part of our larger relationship.

THE NEGOTIATING RECORD

Our work ever since has proceeded based on awareness of these deeper realities, and commitment to address the more fundamental challenges to our trade relationship.

Our first major agreement – the Framework Agreement President Clinton and then-Prime Minister Miyazawa concluded before the G-7 meeting in Tokyo – recognized America's responsibilities, calling for sharp cuts in a budget deficit which had reached $290 billion in 1992. We fulfilled this pledge through the 1993 budget, which is largely responsible for not only eliminating our fiscal deficit but creating a $211 billion surplus.

Likewise, Japan agreed to negotiations -- covering a range of specific industrial sectors and cross-cutting structural issues of competition, transparency and investment -- to address questions about the Japanese economy that had given rise to tensions, to give Japanese consumers greater choice and better prices; create opportunities for exporters and ease imports into Japan, and ultimately to create a more open, competitive and stronger Japanese economy.

Since 1993 we have negotiated 39 market-opening agreements, in industries from cell phones and insurance to apples, semiconductors, harbor practices, civil aviation, and automobiles. We have worked equally hard with Japan, at all levels of government and in consultation with our private sectors, to ensure that these agreements are fully implemented.

Since 1997, we have supplemented our bilateral negotiations, and work in APEC and the WTO, with the Enhanced Initiative on Deregulation and Competition Policy. Through this we find ways to spark competition in Japan and thus reduce the cost of essential services and goods – telecommunications, housing, energy, financial services, pharmaceuticals and medical devices – and promote reform across the economy through stronger competition policy, distribution, transparency in regulatory procedures, and other measures. In doing so we create opportunities for American firms and new Japanese businesses; more efficiency and better growth prospects for Japan's economy as a whole; innovative products and better prices for Japanese families.

NEGOTIATING RESULTS

Much of the work has been to good effect.

Since 1992, despite Japan's long recession, the U.S. have enjoyed $15 billion in growth of goods and services exports to Japan. This has been especially strong in some sectors covered by our agreements, such as semiconductors and medical equipment. The growing ability of foreign businesses to invest in Japan is another indicator, with U.S. direct investment in Japan rising by $12 billion in 1999. And many of our agreements are making their proper contribution to a more competitive, less regulated and consumer-friendly Japanese economy:

– <u>Cellular phone deregulation</u> – a direct result of our 1994 bilateral agreement – has brought new products at better prices to Japan. As a result, two in five Japanese now own cell phones; private investment in mobile service is likely to reach $14 billion this year; and millions of families and hundreds of thousands of businesses enjoy greater convenience and efficiency.

– <u>Electricity Deregulation</u>: A competitive energy market means reduced costs for manufacturers, reduced expenses for households, and long-term economic health; and our Enhanced Initiative has helped shape Japan's liberalization of the retail electricity market. Japan took its first major step last March, when it opened one-third of its energy market to competition, creating business opportunities for U.S. firms and lowering energy costs which are now the highest of any developed country.

– Our work on <u>housing</u> has led to adoption of performance-based standards which are reducing the cost and increasing the quality of new homes for Japanese families. We are now going on to other measures -- allowing construction of four-story, multi-family and mixed housing; revisions in the Land and House Lease Law -- which we estimate will increase housing starts near Tokyo by 17%.

We can cite similar examples of success in other fields: from deregulation of medical equipment and pharmaceuticals, which will speed the introduction of new medicine and medical devices, to better prices for apples in supermarkets and more efficient port practices. But these successes are balanced by areas where we must do more and do better.

CONTINUING CONCERNS

Some of our agreements have not reached their potential. Flat glass is one example, where market shares for Japan's three domestic producers have remained unchanged for nearly three decades; in the aftermath of our agreement, these firms appear to be using Japan's recession and the resulting tight credit market to strengthen control of distribution channels and therefore of sales. Other cases include construction and government procurement. These are sectors valued at many trillions of yen a year, with effects touching the entire Japanese economy; and in which restrictive policies continue to raise prices and tax burdens for Japanese citizens and firms; reduce quality and sometimes safety; weaken Japan's growth prospects and block imports.

Other agreements need new consideration. The auto agreement, for example, expires later this year. Its renewal will be a central task for us in the coming months. This sector, today as throughout the past decades, makes up the bulk of our trade imbalance. During the recession this has worsened, as foreign companies are losing sales year over year and at a rate that far exceeds declines for Japanese manufacturers – to the point where last year Japan exported about 1.5 million cars to the United States, and the U.S. about 50,000 to Japan. Continued restrictive practices in this sector are intolerable.

More broadly, the closed markets and over-regulation we encountered in 1993 are only partially addressed. The results are evident in Japan's long period of slow growth or recession, and also in our trade statistics – eight years ago, Japan made up a seventh of America's two-way trade. This has now shrunk to less than a tenth, with Japan's share of our exports dropping and its market share in the U.S. dropping as well. And this is not because Japan has turned elsewhere -- in fact, Japan relies more heavily today on the American market for exports than it did in 1992.

THE CURRENT AGENDA

These problems are not insoluble. But they do require full commitment by both sides. While many business leaders and intellectuals in Japan recognize the scope of these problems, our counterparts in the Japanese government have at times been reluctant to discuss these issues. This raises the prospect of more serious trade disputes between our countries; and also questions about Japan's ability to sustain a commitment to the reforms the economy so clearly needs.

A central item on our agenda this week – one directly related to the G-8 Summit's focus on information technology – is a perfect example. For the past few days, we have been conducting intensive negotiations over NTT's interconnection fees – a topic which may seem arcane, but has an immediate impact on individual Japanese and Japan's broader economic prospects. The future of any modern economy depends on bringing down the cost of sharing and transporting information, and developing innovative ways to bring people and companies into a networked economy. With the exception of the wireless sector, Japan has lagged in adapting to this reality. According to a recent survey, it ranks only 21st in readiness for e-commerce.

Contributing to this is NTT's special position in the market – the dominance in the wireline market it has always enjoyed. With all its competitors forced to use NTT lines to reach NTT's customers – that is, 98% of all wireline subscribers – NTT has been able to charge what it wants for access to its customers and thus restriction competition. The result is phone rates 2-5 times above those of its peers, which in turn means similar disparities in the retail price of phone calls and Internet access. With NTT collecting fees from 94% of Japan's fixed-line Internet traffic, rates for Internet access run 8-10 times above American levels.

These costs have kept millions of Japanese high-school and college students off the Net. They mean that hundreds of thousands of Japanese small businesses take less advantage of electronic commerce than their competitors elsewhere in the world. And they deprive Japanese exporters of the instantaneous contact with customers the modern world demands. Thus, and together with other restrictions in the telecommunications industry, they have put Japan behind much of the world in Internet access and the use of electronic commerce. This has great implications for Japan's technological and economic future – and it is only one example of a phenomenon all too common in many industries, from energy to housing, construction and more.

RESULTS OF NEGOTIATIONS

As we look ahead, restoration of demand-led growth at home remains essential, and sustained growth will require appropriate use of all economic policy tools. This includes macroeconomic policies, of course; and the issues we took up this week on structural change and market-opening deregulation also are, as in 1993, critical for broader economic revival in Japan as well as for trade.

1. NTT Interconnection Agreement

First, we have agreed on substantial reduction of NTT's interconnection fees. Under our agreement, fees for interconnecting with the NTT system on a regional level – of greatest importance to American carriers – will fall by 50% over the next two years, retroactive to April 2000. The bulk of the reduction comes this year. Over the same period, NTT will reduce local switching fees by 20%. These rate cuts will save competitive carriers – and thus Japan's schools and families, as well as foreign and domestic companies – over $2 billion in the next two years.

Then, by 2002, the Japanese government will conduct a thorough review of interconnection rates, which should result in substantial additional reductions, finally bringing Japan's rates into line with those of other competitive markets. Together with this, we agreed on a number of related reforms: the ability to lease subscriber lines on an "unbundled basis," to permit competitors to NTT to roll out high-speed Internet access; removal of restrictions on how new entrants structure their operations and build out their networks, permitting them to adapt more quickly to market demands; guaranteed access to NTT facilities where competitors need to install their own equipment; and more timely and cost-effective access to rights-of-ways companies need to build competing networks. As a package, this will help to create a market which is easier companies to enter, and alternate networks that are less expensive for Japanese businesses and families to use, thus stimulating the kind of innovation in areas such as the Internet which promote growth and technological advances throughout the economy.

2. Next Steps on Deregulation

Second, with completion of the Joint Status Report on the third year of the Enhanced Initiative, we are announcing a major new set of deregulatory measures. These will promote growth and reduce costs in critical services industries – energy, telecommunications, finance, law and others – at the heart of a modern high-tech economy, as they also create opportunities for American and Japanese businesses and help meet consumer needs. Highlights here include:

– Energy: Japan will work to reduce prices by implementing and enforcing rules that ensure non-discriminatory access to the electricity transmission grid; disclose information on development of transmission rates, eliminate the antitrust exemption for natural monopolies, and establish a non-discriminatory framework for access to the natural gas market in anticipation of liberalization next year.

– Medical equipment and pharmaceuticals: We have agreed on 25 specific measures to help meet the challenge of providing high-quality, affordable health care for an aging population. These include reducing approval processing time for new drugs from 18 to12 months; creating an appeals process for unfavorable pricing decisions on new medical devices and pharmaceuticals; and eliminating unnecessary regulations on many vitamins and minerals, for example with respect to the shape of vitamin pills. This will make it cheaper and faster for foreign companies to bring innovative, life-saving drugs and medical devices into Japan.

– Financial services: Japan will build on its "Big Bang," creating efficiency and choice through, e.g., allowing financial services firms to compete in a larger range of industries through subsidiaries, and strengthening competition for pension fund business. It will also make oversight of these industries more transparent to the public and affected businesses, as the Financial Services Agency will create a system for responding to written inquiries, including published guidance and no-action letters.

– Insurance: Japan will help new and innovative products move more quickly to the market, make regulation more transparent as in the case of financial services, and ensure that all interested parties are able to comment on any plans to expand the state-owned postal insurance system. In parallel with this, noting the improvements our bilateral 1994 and 1996 deregulation agreements have made to the product approval process, availability of new products, and progress toward deregulation of the primary insurance sector, I informed Commissioner Hino today that provisions of these agreements restricting certain activities in the third sector will be lifted on January 1st, 2001. The insurance agreements remain in force now and after that date, and we expect full implementation of these provisions, including pro-active efforts to ensure that there is no inappropriate activity related to this sector before January 1st, 2001.

– Housing: Here, we will continue our work to make the housing market more competitive, and thus make houses more affordable for young families, by reducing restrictions against four-story wood-frame buildings, improving housing appraisals and making mortgage terms for resale housing more compatible with terms for new houses.

– Law: Japan will begin modernizing and reforming the legal system, creating a Judicial Reform Council to oversee the process; and taking some initial steps through lifting a ban on advertising by lawyers and increasing the number of successful applicants to the Bar Exam by an initial 1000 slots.

– Structural reform: In parallel with these reforms in specific industries, we have continued to move ahead with broader structural measures in distribution and competition policy, through strengthened Antimonopoly Law enforcement and other means.

3. Future Agenda

The Enhanced Initiative has been successful and important for both of us, helping create growth in Japan and promote competition, while improving access for foreign firms. Moreover, it has helped to channel potential disputes into a mutually beneficial, "win-win" framework. Its extension will go together admirably with Prime Minister Mori's plan for a second three-year deregulation plan. There are important issues to be addressed in Japan in the coming year which will be complemented by our joint work, such as natural gas deregulation, introduction of broadband technology, and pharmaceutical pricing reform. There is no better way for Japan to demonstrate its firm commitment to reform than to endorse a fourth year of the Initiative.

We are also discussing some more specific bilateral issues, including autos, flat glass, government procurement, insurance and others. And, of course, we will work with Japan on the agenda of the World Trade Organization as well. With the opening of WTO negotiations on agriculture and services, we have recently offered both a comprehensive proposal for agricultural trade reform and a plan for wide-ranging liberalization of services. We are now seeking consensus on broadening these into a new Round covering additional issues of mutual concern.

CONCLUSION

As in each step to date, the results will be of mutual benefit. They will help to stimulate trade and export opportunities; they will foster Japanese entrepreneurial development; and they will offer to Japan's public greater choice, lower prices and higher living standards.

This has been the goal of our trade negotiations not only this week but for the past seven years. Much has changed since 1993 – in our bilateral relationship, in the political landscape of the Pacific, and in both our countries. But the most important facts remain: the shared values and deep human ties that bring us together; the responsibilities we share as the world's economic leaders and as fellow democracies; the fact that today as then, a strong and enduring alliance will enable our two countries to face the challenges of the new century with greater confidence.

This was the responsibility before us when we came to Tokyo seven years ago; and it will remain our task as the leaders depart from Okinawa in the days ahead.

Thank you very much, and now let me take your questions.